Report

of the

Examination of

Trade Lake Mutual Insurance Company

Frederic, Wisconsin

As of December 31, 2002

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State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

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May 9, 2003

Honorable Jorge Gomez
Commissioner of Insurance
State of Wisconsin
125 South Webster Street
Madison, Wisconsin 53702

Commissioner:

In accordance with your instructions, an examination has been performed as of December 31, 2002, of the affairs and financial condition of

Trade Lake Mutual Insurance Company
Frederic, Wisconsin

and the following report thereon is respectfully submitted:

I. INTRODUCTION

The last examination of this company was made in 1998 as of December 31, 1997. The current examination covered the intervening time period ending December 31, 2002, and included a review of such subsequent transactions deemed essential to complete this examination.

The Summary of Examination Results contains elaboration on all areas of the company's operations. Special attention was given to the action taken by the company to satisfy the recommendations and comments made in the previous examination report.

The company was originally organized as a town mutual insurance company on March 11, 1874, under the provisions of the then existing Wisconsin Statutes. The original name of the company was Trade Lake Mutual Fire Insurance Company. Subsequent amendments to the company's articles and bylaws changed the company's name to that presently used.

During the period under examination, there was one amendment to the articles of incorporation that reduced the number of company directors from nine to seven. There were no amendments to the bylaws.

A review of the certificate of authority revealed that the company is currently licensed to write business in the following counties:

Barron, Burnett, Douglas, Polk, Sawyer and Washburn

The company is currently licensed to write property, including windstorm and hail, and

non-property insurance. Homeowners, fire and farmowners policies are the company's principal lines of coverage.

A review was made of the policy and application forms currently used by the company. The company issues approved policies, with or without endorsements, for terms of three months, six months, or one year, with premiums payable on the advance premium basis. Policy fees charged policyholders are retained by the company.

Business of the company is acquired through 18 agents, 6 of whom are directors of the company. Agents are presently compensated for their services as follows:

Type of Policy	**Compensation**
All policies (New or Renewal)	12½%

According to the adjusting guidelines, adopted in April 2000, two board-elected director-agents have the authority to adjust losses up to $2,000. However, they are not allowed to adjust losses for the policies they write. Director-agent adjusters receive $20 per hour for each loss adjusted plus $0.365 per mile for travel allowance. Losses in excess of $2,000 are adjusted by outside adjusters.

Policyholders may participate in the management and control of the company by attending and voting at all annual or special meetings of the members. No member may vote by proxy. The annual meeting of the company for the election of directors and special meetings of the company are held in accordance with its articles of incorporation.

Board of Directors

The board of directors consists of seven members divided into three classes. One class is elected at each annual meeting for a term of three years. Vacancies on the board may be filled by the directors for the interim to the next annual meeting when a director shall be chosen for the unexpired term.

The current board of directors consists of the following policyholders of the company:

Name	Principal Occupation	Residence	Expiry
*Wayne Gustafson	Accountant	Frederic, WI	2005
*Susan Hughes	Adm. Asst./ Ins. Agency	Frederic, WI	2004
*Raphael Kosloski	Retired	Siren, WI	2006
*Neil Anderson	Farmer/Insurance Agent	Barronett, WI	2006
*Roger Danielson	Farmer/Insurance Agent	Grantsburg, WI	2006
*Charles R. Johnson	Insurance Agent	Grantsburg, WI	2005
Gregg Westigard	Newspaper Reporter	Frederic, WI	2004

Directors who are also agents are identified with an asterisk.

Members of the board currently receive $75.00 for each meeting attended and $0.365 for travel expenses.

Officers

Officers are elected by the board of directors from among its members and hold office for one year or until their successors are duly elected and qualified. Officers and manager serving at the present time are as follows:

Name	Office	2002 Salary
Charles R. Johnson	President	$3,500
Roger Danielson	Vice President	$2,000
Neil Anderson	Secretary/Treasurer	$2,000
Ginger Baker	Manager	$40,745

Committees of the Board

The company's bylaws allow for the formation of certain committees by the board of directors. The committees at the time of the examination are listed below. The Investment Committee and Business Plan Committee were organized in 2003.

Adjusting Committee
Charles R. Johnson, Chair
Roger Danielson
Neil Anderson

Investment Committee
Charles R. Johnson, Chair
Roger Danielson
Neil Anderson

Business Plan Committee
Charles R. Johnson, Chair
Wayne Gustafson
Gregg Westigard

Growth of Company

The growth of the company during the past five years as compiled from its filed annual statements was as follows:

Year	Net Premiums Earned	Net Losses and LAE Incurred	Policies In Force	Net Income	Admitted Assets	Policyholders' Surplus
1998	$577,377	$552,291	2,400	$(129,288)	$1,336,209	$659,744
1999	434,443	423,007	2,281	(137,373)	1,127,917	519,685
2000	503,620	382,082	2,142	(52,852)	1,103,187	530,759
2001	517,222	475,765	2,044	(213,532)	1,031,190	296,734
2002	583,822	211,233	1,902	135,875	945,647	361,712

The ratios of premiums written, gross and net, to surplus as regards policyholders during the past five years were as follows:

Year	Gross Premiums Written	Net Premiums Written	Ending Surplus	Writings Ratios Gross	Net
1998	$1,038,917	$575,505	$659,744	157%	87%
1999	976,375	449,149	519,685	188	86
2000	992,584	455,440	530,759	187	86
2001	1,076,361	530,902	296,734	363	179
2002	1,135,695	624,599	361,712	314	173

For the same period, the company's operating ratios were as follows:

Year	Net Losses and LAE Incurred	Net Other Underwriting Expenses Incurred	Net Earned Premiums	Loss Ratio	Expense Ratio	Composite Ratio
1998	$552,291	$216,281	$577,377	96%	38%	134%
1999	423,007	198,315	434,443	97	44	141
2000	382,082	189,791	503,620	76	42	118
2001	475,765	260,555	517,222	92	49	141
2002	211,233	241,928	583,822	36	39	75

The company reported net income for 2002, which was the first time since 1996. The company has been experiencing high loss ratios with resulting decreases to surplus. Prior to 2002 the company had eleven consecutive years of underwriting losses, and lost 58% of surplus since 1996. The company had unusually high losses in 1997, 1998 and 2001 as shown in the following table:

	Gross Losses Incurred	Gross Incurred Loss Ratio
1997	$1,307,015	147%
1998	1,616,372	155
1999	560,507	59
2000	629,946	63
2001	4,235,711	397
2002	518,661	47

Losses incurred in 1997 and 1998 were largely a result of hail and windstorms; high losses in 2001 were due to the Siren tornado on June 18.

A self-imposed moratorium on new business was set into place October 19, 2001, at the time of acceptance of the Business Plan by the Board of Directors, to address concerns about their high loss ratios and declining surplus. The Business Plan will be further discussed in the section Summary of Examination Results in the area captioned “Business Plan.” This moratorium continued through the remainder of 2001 and all of 2002. During that time the company and its agents concentrated on re-underwriting risks, reviewing and increasing rates, executing their inspection program, and insuring dwellings to value. On January 1, 2003, the company removed the moratorium with the understanding that all new business would be monitored and growth would be minimal.

II. REINSURANCE

The examiners' review of the company's reinsurance portfolio revealed there is currently one ceding treaty. The treaty contained a proper insolvency clause and complied with s. Ins 13.09 (3), Wis. Adm. Code, concerning maximum wind loss. Company retentions of risk complied with s. Ins 13.06, Wis. Adm. Code.

Reinsurer:	Wisconsin Reinsurance Corporation (WRC)
Effective date:	January 1, 2003, continuous
Termination provisions:	Either party may terminate this contract as of any subsequent January 1 by giving to the other party at least 90 days advance notice in writing.

The coverages provided under this treaty are summarized as follows:

1.	Type of contract:	Class A, Excess of Loss
	Lines reinsured:	All casualty business written by the company
	Company's retention:	$5,000 in respect to each and every loss occurrence. Annual aggregate of net losses not to exceed an amount equal to 60% of net casualty premiums written with a minimum retention of $50,000.
	Coverage:	100% of each and every loss occurring on the business covered by this contract, including loss adjustment expenses, subject to maximum policy limits of $1,000,000 per occurrence, $1,000,000 split limits, $5,000 for medical payments, per person; $25,000 per accident.
	Reinsurance premium:	42.50% of casualty premium written for each and every policy issued.
	Ceding commission:	None

2.	Type of contract:	Class B, First Surplus
	Lines reinsured:	All property business written by the company
	Company's retention:	$300,000 on each and every risk
	Coverage:	When risk is $300,000 or more reinsurer is obligated to accept up to $800,000 on a pro rata basis. When risk is $300,000 or less reinsurer is obligated to accept up to 50% of risk on a prorata basis
	Annual aggregate deductible:	Company retains the first 10% of losses and loss adjusting expenses otherwise recoverable under this contract
	Reinsurance premium:	Pro rata portion of all premiums, fees, and assessments charged by the company, corresponding to the amount of each risk ceded
	Ceding commission:	15% sliding scale, subject to loss experience Minimum = 15.00%; Maximum = 35.00%
3.	Type of contract:	Class C, Excess of Loss (First Layer)
	Lines reinsured:	All property business written by the company
	Company's retention:	$25,000, including loss adjusting expense, in respect to each and every risk resulting from one loss occurrence
	Annual aggregate deductible:	First $25,000 of paid losses otherwise recoverable under this contract shall be retained by the company, subject to class D/E stop-loss reinsurance
	Coverage:	100% of any loss, including loss adjusting expense, in excess of $25,000, subject to a limit of liability to the reinsurer of $75,000
	Reinsurance premium:	For each annual period, reinsurance premium is determined by taking the sum of the four years' losses incurred by the reinsurer divided by total net premiums written for the period multiplied by the factor of 100/80ths, subject to: Minimum rate: 7.00% of current net premiums written Maximum rate: 23.75% of current net premiums written The rate for the current annual period is 12.50%
	Ceding commission:	None

4.	Type of contract:	Class C, Excess of Loss(Second Layer)
	Lines reinsured:	All property business written by the company
	Company's retention:	$100,000 in respect to each and every risk resulting from one loss occurrence
	Coverage:	100% of any loss, excluding loss adjusting expense, in excess of $100,000, subject to a limit of liability to the reinsurer of $200,000 in respect to each and every loss occurrence
	Reinsurance premium:	1.25% of the company's net premiums written in respect to the business covered
5.	Type of contract:	Class D/E, Stop Loss
	Lines reinsured:	All property business written by the company
	Company's retention:	60% of the company's net premiums written, including loss adjustment expenses, subject to a minimum net retention of $400,000
	Coverage:	100% of any loss, including loss adjustment expenses, if the company's aggregate losses exceed 60% of net premiums written
	Reinsurance premium:	For each annual period, calculated as the sum of the losses incurred by the reinsurer under this contract in the eight years preceding the year just concluded, divided by the total net premiums written for the same period, multiplied by the factor 100/80ths, subject to: Minimum rate: 5.50% of current net written premium Maximum rate: 25.00% of current net written premium The rate for the current period is 12.00%

III. FINANCIAL DATA

The following financial statements were filed with the Commissioner of Insurance in the company's annual statement at December 31, 2002. Adjustments made as a result of the examination are noted at the end of this section in the area captioned "Reconciliation of Policyholders' Surplus."

Trade Lake Mutual Insurance Company
Statement of Assets, Liabilities and Policyholders' Surplus
As of December 31, 2002

Assets	Ledger	Nonledger	Not Admitted	Net Admitted
Cash in Company's Office	$ 50	$	$	$ 50
Cash Deposited in Checking Account	24,492			24,492
Bonds (at Amortized Cost)	346,055			346,055
Stocks or Mutual Fund Investments (at Market)	336,859			336,859
Real Estate	40,468			40,468
Premiums and Agents' Balances and Installments:				
In Course of Collection	1,086		271	815
Deferred and Not Yet Due	166,173			166,173
Investment Income Accrued	5,986			5,986
Reinsurance Recoverable on Paid Losses and LAE	4,977			4,977
Electronic Data Processing Equipment	2,467			2,467
Other Assets:				
Expense Related:				
Reinsurance Contingent Commission Receivable	17,305			17,305
Furniture and Fixtures	74		74	0
TOTALS	$ 945,992	$	$ 345	$ 945,647

Liabilities and Surplus

Net Unpaid Losses	$ 36,110
Unpaid Loss Adjustment Expenses	3,623
Commissions Payable	28,709
Fire Department Dues Payable	741
Unearned Premiums	394,163
Reinsurance Payable	91,410
Amounts Withheld for the Account of Others	2,136
Other Liabilities:	
Accounts Payable	4,118
Premiums Received in Advance	22,925
TOTAL LIABILITIES	583,935
Policyholders' Surplus	361,712
TOTAL	$ 945,647

Trade Lake Mutual Insurance Company
Statement of Operations
As of December 31, 2002

Net Premiums and Assessments Earned		$ 583,822
Deduct:		
Net Losses Incurred	175,056	
Net Loss Adjustment Expenses Incurred	36,177	
Other Underwriting Expenses Incurred	241,928	
Total Losses and Expenses Incurred		453,161
Net Underwriting Gain (Loss)		130,661
Net Investment Income:		
Net Investment Income Earned	5,131	
Net Realized Capital Gains	114	
Total Investment Income		5,245
Other Income:		
All Other	(31)	
Total Other Income		(31)
Net Income (Loss)		$ 135,875

Trade Lake Mutual Insurance Company
Reconciliation and Analysis of Surplus as Regards Policyholders
For the Five-Year Period Ending December 31, 2002

The following schedule is a reconciliation of surplus as regards policyholders during the period under examination as reported by the company in its filed annual statements:

	1998	**1999**	**2000**	**2001**	**2002**
Surplus, beginning of year	$ 761,899	$ 659,744	$ 519,685	$ 530,759	$ 296,734
Net income	(129,288)	(137,373)	(52,852)	(213,532)	135,875
Net unrealized capital gains or (losses)	25,197	(3,664)	62,984	(21,261)	(71,013)
Change in non-admitted assets	1,936	978	942	768	116
Surplus, end of year	$ 659,744	$ 519,685	$ 530,759	$ 296,734	$ 361,712

Reconciliation of Policyholders' Surplus

A reconciliation of the policyholders' surplus as reported by the company in its filed annual statement and as determined by the examination is detailed in the following schedule:

Policyholders' Surplus per December 31, 2002, Annual Statement			$ 361,712
Item	**Increase**	**Decrease**	
Net Unpaid Losses	7,966	0	
Total	$ 7,966	$ 0	
Increase to Surplus per Examination			7,966
Policyholders' Surplus per Examination			$ 369,678

Reclassification Account	**Debit**	**Credit**
Deferred Premium		8,087
Advance Premium	8,087	
Total	$ 8,087	$ 8,087

IV. SUMMARY OF EXAMINATION RESULTS

Compliance with Prior Examination Report Recommendations

Comments and recommendations contained in the last examination report and the action taken on them by the company are as follows:

1. Corporate Records -- It is suggested that the company establish a board policy on how long company issues can be tabled before a decision is required, so that key corporate issues are decided upon promptly.

   Action -- Compliance.

2. Corporate Records -- It is recommended that the company revise its business plan to include shorter term planning and actions to be taken to fulfill the goals identified in this plan.

   Action -- Compliance.

3. Conflict of Interest -- It is recommended that the directors of the company properly disclose all potential conflicts on the annual conflict of interest statements.

   Action -- Partial compliance, see comments in the Current Examination Results section of this report under the caption, “Conflict of Interest”.

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4. Underwriting -- It is recommended that the company establish a formal inspection procedure for new and renewal business, whereby a sampling of new applications and renewal business is inspected by committee members or a professional inspector independent of the risk under consideration.

   Action -- Compliance.

5. Underwriting -- It is recommended that the company establish a system which documents in the underwriting file how the risk was valued using valuation guides, and include photographs of the risks.

   Action -- Partial compliance, see comments in the Current Examination Results section of this report under the caption, “Underwriting”.

6. Underwriting -- It is suggested that the company add the ten-day notice language to the billing notice to the policyholder and lapse the policy if no payment is received.

   Action -- Compliance.

7. Underwriting -- It is suggested that the company establish a consistent policy which either provides cancellation at the expiration date or charges pro rata for coverage extended to the policyholder beyond the expiration date.

   Action -- Compliance.

8. Claims Adjusting -- It is recommended that the adjusting committee perform the duties required by s. 612.13 (4), Wis. Stat.

   Action -- Compliance.

9. Claims Adjusting -- It is recommended that the company amend the agent agreement and or the adopted adjusting guidelines so that they are in accordance with one another and in compliance with s. 612.13 (4), Wis. Stat.

    Action -- Compliance.

10. Claims Adjusting -- It is further recommended that the company consistently follow the adjusting guidelines that it has established.

    Action -- Compliance.

11. EDP Environment -- It is suggested that the company do the daily back up earlier in the evening, closer to the end of the work day so that the tapes can be placed in the fire-proof cabinets prior to leaving the office.

    Action -- Compliance.

12. Disaster Recovery Plan -- It is recommended that the company adopt and implement a disaster recovery plan.

    Action -- Compliance.

13. Policy Forms -- It is recommended that the company review and update the policy forms currently in use, to comply with current regulatory requirements.

    Action -- Compliance.

14. Invested Assets -- It is recommended that the company develop a comprehensive investment plan that is continuously reviewed and updated.

    Action -- Compliance.

15. Invested Assets -- It is recommended that the company make no additional Type 2 investments until the company meets the required amount of Type 1 investments, pursuant to s. Ins 6.20 (6) (c), Wis. Adm. Code.

    Action -- Compliance.

16. Cash and Invested Cash -- It is recommended that the company establish a liability for escheatable funds, and that the company file unclaimed property reports in accordance with ch. 177, Wis. Stat.

    Action -- Compliance.

17. Stocks and Mutual Fund Investments -- It is recommended that the company's investments in mutual funds be in compliance with s. Ins 6.20 (6) (d).

    Action -- Compliance.

18. Stocks and Mutual Fund Investments -- It is further recommended that the company discontinue the practice of reinvesting mutual fund dividends in Type 2 Investments until the company has met the Type 1 Investment threshold.

    Action -- Compliance.

19. Stocks and Mutual Fund Investments -- It is recommended that the company properly report money market funds on Schedule D of the annual statement.

    Action -- Compliance.

20. Net Unpaid Losses -- It is recommended that the company establish an internal review of claim files which ensures documentation of depreciation and betterment, committee review, and salvage and subrogation handling.

    Action -- Compliance.

21. Net Unpaid Losses -- It is further recommended that the company establish a system which returns the deductible to the insured when either $100 amounts are collected or six months of recovery installments have been received.

    Action -- Compliance.

22. Net Unpaid Losses -- It is suggested that the company develop and implement a more extensive loss analysis.

    Action -- Compliance.

Current Examination Results

Corporate Records

The minutes of the annual meetings of policyholders and meetings of the board of directors and any committees thereof, were reviewed for the period under examination and also for the subsequent period. During the prior examination it was noted that the board of directors was tabling issues that are critical to the company's financial condition. The current examination noted improvement by the board of directors after a policy was established at the February 28, 2002 meeting. This policy required action be taken at the next board meeting after an issue has been presented. Prior to this policy being established, the examination found that the board of directors did not resolve critical decisions for several months.

During the review of company minutes it was also noted that the board did not approve bond investments purchased November, 1998 through October, 2002. Subsequent to the examination date, on May 13, 2003, the Investment Committee established a policy to allow the manager to purchase bonds, currently ranging in interest of 4.75% to 4.95% for A to AA rated bonds without a meeting of the committee.

Biographical data relating to company officers and directors have not been reported in accordance with the provisions of s. Ins 6.52, Wis. Adm. Code. A biographical sketch has not been filed for Wayne Gustafson, who was elected to the board in October, 1998, and Gregg Westigard, who was elected to the board in April, 2000. It is recommended that the company report biographical data to the Commissioner within 15 days of the election or appointment of a new director or officer, in accordance with the provisions of s. 612.15 (1), Wis. Stats.

The company has executed formal written agreements with its agents. The contracts include language indicating the agent will represent the company's interests "in good faith."

Business Plan

On October 9, 2001, the company adopted a business plan and budget to cover the years of 2002, 2003 and 2004. The business plan set forth defined duties and responsibilities for the board and the manager; established timelines and resources for improvements in the company's inspection process, loss adjustment process, and agent underwriting standards; and established a moratorium on new business. The examination noted the company's progress with the business plan's following goal and strategies:

GOAL

1. Creating a New Order of Command

Progress – The company appears to have re-established the duties and responsibilities of the major personnel involved with the company as outlined by the business plan.

STRATEGIES

1. Separation of Duties

Progress – Currently the manager has the final decision of risk acceptance. Each month the board is provided with a report from management containing current issues, financial information, and information on losses and reserves, policy count and premiums.

2. Inspections

Progress – As of May 2, 2003 the company is 50% complete with having an independent inspector inspect all renewal business. The company placed priority on inspecting farm policies, then continued with fire and country homeowner policies. Lowest priority was given to preferred homeowner policies. All new applicants are inspected by an independent inspector within the first 30 days of the policy term to determine acceptability. In cases of inaccurate valuation, the insured will receive a 60-day notice of renewal with altered terms indicating the amount of coverage change.

3. Adjustment of Losses

Progress – Agents no longer adjust losses, with the exception of two director-agents elected by the board to adjust risks with an expected maximum loss of $2,000 or less. The two director-agents are not allowed to adjust a risk on their own policy or any of their policyholders. Losses in excess of $2,000 are being adjusted by an independent adjuster. The adjuster for a loss is determined by the manager.

4. Agents Practices

Progress – The company has updated its underwriting manual to include stricter and more concise standards. Agents have been provided with a copy of the Business Plan and access to the underwriting manual and are required to comply with all facets of it.

5. Business

Progress – A moratorium on new business was set in place on October 19, 2001 at the time of acceptance of the Business Plan by the board of directors. The moratorium continued through the remainder of 2001 and all of 2002. During that time the company and its agents concentrated on re-underwriting risks, reviewing and increasing rates, executing their inspection program, and insuring to value. As of May 2, 2003 the company is within the final six months of the three-year program to recalculate insurance to value on all dwellings and have just begun applying the same standards to outbuildings. Agents are required to provide pictures of all insured buildings and copies of their calculations to establish values.

Conflict of Interest

In accordance with a directive of the Commissioner of Insurance, each company is required to establish a procedure for the disclosure to its board of directors of any material interest or affiliation on the part of its officers, directors, or key employees which conflicts or is likely to conflict with the official duties of such person. A part of this procedure is the annual completion of a conflict of interest questionnaire by the appropriate persons. The company has adopted such a procedure for disclosing potential conflicts of interest. Conflict of interest questionnaires were reviewed for the period under examination with the only potential conflict disclosed being that six director-agents write for other insurance companies. None of the companies listed on the conflict of interest questionnaires would be considered direct competition to Trade Lake Mutual Insurance Company.

Upon review of the agent licensing database maintained by OCI, it was again noted that several directors of Trade Lake Mutual are listed as agents for other insurance companies that were not disclosed on the conflict of interest statements. It is again recommended that the directors properly disclose all potential conflicts on the annual conflict of interest form. The examination did note there was uncertainty with board members as to what would be considered a conflict of interest. It is also suggested that the board of directors clarify their conflict of interest questionnaire to define circumstances that would be considered conflicts.

During the review of the minutes of the board meetings, it was noted that the minutes did not reflect abstentions by the officers when their salaries were voted upon. It is recommended that directors abstain on issues where a conflict of interest exists per s. 612.18, Wis. Stat. and such abstentions are to be included in the board minutes.

Fidelity Bond and Other Insurance

The company is afforded coverage under the terms of the following bonds or contracts and has complied with s. Ins 13.05 (6), Wis. Adm. Code, which sets forth the minimum requirements for fidelity bond coverage:

Type of Coverage	Coverage Limits
Fidelity bond	$ 80,000
Fidelity bond – Employee 401(k) Plan	10,000
Professional liability	1,000,000 each claim/aggregate limit $5,000 deductible
Directors and officers liability	1,000,000 each claim/aggregate limit $5,000 deductible
Agents Errors & Omissions	1,000,000 each claim/aggregate limit $1,500 deductible
Property/Liability:	
Building	100,000
Business personal property	60,000
Property off premises	45,000
Each occurrence	1,000,000
Medical per person	1,000
Aggregate (not products/completed work)	2,000,000
Aggregate (products/completed work)	1,000,000
Fire Legal Liability	100,000
Worker's compensation	Wisconsin Requirements
Employer's Liability:	
Bodily injury by accident	100,000 each accident
Bodily injury by disease	100,000 each employee
Bodily injury by disease	500,000 policy limit

Underwriting

The company has a written underwriting guide. The guide covers all the lines of business that the company is presently writing. All applications are reviewed by the underwriter and manager for compliance to guidelines. The company utilizes general WRC guidelines for its liability business.

The company has a formal inspection procedure for both new and renewal business. As of October 9, 2001, it is company's policy to have an outside source inspect all properties at policy inception, and every three years thereafter. In addition, the company is in the process of having all renewal business inspected by an outside source.

A sampling of new applications and of renewal business was reviewed and revealed that the company is following its inspection procedures by requiring photographs of the properties and documentation of how risk was valued, with the exception of outbuildings. It is again recommended that the company document in the underwriting file how outbuildings were valued using valuation guides and include photographs of the risk.

The prior examination found the company’s billing notice did not include language which provided that non-payment within ten days would result in cancellation. The company has since revised its billing notice to include a provision with the appropriate language. All policies reviewed during examination that were cancelled for non-payment were cancelled on the eleventh day after the notice was given.

Claims Adjusting

The company has an adjusting committee consisting of three directors, as required by s. 612.13 (4), Wis. Stat. The function of this committee is to adjust or supervise the adjustment of losses. A review of the company’s minutes indicated that the adjusting committee meets every other month and they actively participate in adjusting or supervising the adjustment of losses.

The company has established claims adjusting guidelines, adopted in May, 2000. The new guidelines state that agents no longer adjust claims with the exception of two director-agents appointed by the board. The director-agents can adjust risks which have an expected maximum loss of $2,000 or less. The two director-agents are not allowed to adjust a risk on their own policy or any of their policyholders. Losses in excess of $2,000 are to be adjusted by an outside adjuster.

Accounts and Records

The examiners' review of the company's records indicated that the company is in compliance with s. Ins 13.05, Wis. Adm. Code, which sets forth the minimum standards for the handling of cash and recording of cash transactions by town mutual insurance companies. The examiners noted the following:

1. A proper policy register is maintained
2. A proper cash receipts journal is maintained
3. A proper cash disbursements journal is maintained
4. A proper general journal is maintained
5. A proper general ledger is maintained

An extensive review was made of income and disbursement items. Cash receipts were traced from source records and the proper recording and eventual deposit thereof ascertained. Negotiated checks issued during the period under examination were reviewed, test checked for proper endorsement, and traced to cash records. The verification of assets and determination of liabilities were made as of December 31, 2002.

The company policy is to have treasurer and manager sign all disbursements. While reviewing disbursement items, the examiners noted that the manager stamps the treasurer's signature and signs her own name. This does not provide a meaningful internal control. It is recommended that the company revise its disbursement policy to require two live signatures on all disbursements over a specified amount approved by the board, pursuant to s. Ins. 13.05(4)(b), Wis. Adm. Code.

The company reported $1,068,205 premium in-force in its annual statement. A report used to calculate the unearned premium reported premium in-force of $1,070,675. A report used to calculate deferred premium reported premium in-force of $1,069,858. This was also the amount of premium in-force in a file provided for the purposes of the examination.

Premium in-force is the basis for calculating both unearned and deferred premium. A consistent amount for premium in-force should be used to calculate unearned and deferred premium. Changes to unearned and deferred premium as a result of differing the premium in-force amounts were considered and determined to be immaterial. It is recommended that the company determine a premium in-force and use that for the basis for unearned and deferred premium.

A review of data from the company's reports found errors in the company's year-end valuations related to net unpaid losses and various premium balances, including deferred, unearned, and advance. Further discussion and recommendation regarding the adjustments and reclassifications to the listed accounts is included in the Current Examination Results section of this report under the specified account.

The company is audited annually by an outside public accounting firm.

EDP Environment

Company personnel were interviewed with respect to the company's Electronic Data Processing environment. The company utilizes WRC's Company Management Program software. A virus protection program is run at each start-up. Access to the computers is limited to authorized personnel.

The last employee to leave the office every evening performs a back-up of the software program and removes the backup from the office. The back-up is returned the second day and a current backup removed that evening. Procedures were developed to assure a current back-up diskette is off-site on any given day. In addition, company also keeps end-of-year back-ups stored in its safety deposit box at a local bank.

A manual which describes how to use the company's software and outlines the steps to complete specific tasks assists in the continuity of operations for seldom-used applications, training, or when staff turnover occurs. The company has manuals documenting the use of its software.

Disaster Recovery Plan

A disaster recovery plan identifies steps to be performed in case the company loses a key employee, is not able to access its computer, information on its computer was lost, or the office building was destroyed, to name a few contingencies. The company has developed and implemented a disaster recovery plan. The disaster recovery plan is to be updated by June of each even-numbered year. A copy of the plan is stored in their safety deposit box. The company's disaster recovery plan appears to be adequate.

Policy Forms

The company policy forms were reviewed and compared with the list of forms filed with OCI. It appears that the company does review and update the policy forms currently in use, to comply with current regulatory requirements pursuant to ss. 631.20 and 625.13, Wis. Stats.

Invested Assets

Section 610.23, Wis. Stat., requires insurers to hold all investments and deposits of its funds in its own name except that:

(1) Securities kept under a custodial agreement or trust arrangement with a bank or banking and trust company may be issued in the name of a nominee of the bank or banking and trust company; and

(2) Any insurer may acquire and hold securities in bearer form.

For securities not held under a custodial agreement or trust arrangement with a bank or banking and trust company, s. Ins 13.05 (4), Wis. Adm. Code, requires that:

> Non-negotiable evidences of company investments such as registered bonds, certificates of deposits, notes, etc., shall be maintained in a safe or vault with adequate safety controls or in a safety deposit box in a bank. Negotiable evidences of company investments shall be maintained in a safety deposit box in a bank. Access to a company safety deposit box containing negotiable securities shall require the presence and signature of at least 2 officers, directors or employees of the company.

The company is not in compliance with these requirements. Access to company safety deposit box containing negotiable securities did not require the presence and signature of at least two officers, directors, or employees of the company. It is recommended that the company comply with s. Ins 13.05, Wis. Adm. Code, as regards custody and control of its invested assets.

The company has negotiated a new custodial agreement with its custodial bank since the prior examination, which does not contain appropriate language with respect to indemnification and prompt replacement in the event of loss of securities. It is recommended that the company's custodial statement include appropriate language with respect to indemnification and prompt replacement in the event of loss of securities.

Investment Rule Compliance

The town mutual investment rule allows a company to invest in common stocks, common stock mutual funds, and other higher risk investments (referred to as "Type 2") provided that the town mutual has a sufficient amount of lower risk investments (referred to as "Type 1"). A town mutual may invest in Type 2 securities only if it already has sufficient Type 1 investments. Type 1 investments must equal or exceed the greater of items 1, 2, or 3.

1.	Liabilities plus $300,000	$881,851
2.	Liabilities plus 33% of gross premiums written	956,630
3.	Liabilities plus 50% of net premiums written	894,151
4.	Amount required (greater of 1, 2, or 3)	956,630
5.	Amount of Type 1 investments as of 12/31/2002	429,846
6.	Excess or (deficiency)	$ (526,784)

The company does not have sufficient Type 1 investments. This office granted the company permission to hold their Type 2 investments, having a statement value of $277,560, but instructed the company to engage in no further acquisition of Type 2 investments until the company achieves Type 1 sufficiency. The company is in compliance with this office's authorization.

It was noted during examination of securities that three bonds, issued by two Minnesota municipalities, were incorrectly reported as Type 1 investments. These investments are considered Type 2 due to being unrated by a rating organization. It is recommended company report the correct Type designation for all securities pursuant to s. Ins 6.20 (6) (d) 9, Wis. Adm. Code.

ASSETS

Cash and Invested Cash **$24,542**

The above asset is comprised of the following types of cash items:

Cash in company's office	$ 50
Cash deposited in banks-checking accounts	24,492
Total	$24,542

Cash in the company's office at year-end represents the company's petty cash fund. A physical count was made by the examiners during the course of the examination and the balance reconciled to year-end.

Cash deposited in banks subject to the company's check and withdrawal consists of two accounts maintained in separate banks. Verification of checking account balances was made by obtaining confirmations directly from the depositories and reconciling the amounts shown thereon to company records.

Book Value of Bonds **$346,055**

The above asset consists of the aggregate book value of bonds held by the company as of December 31, 2002. Bonds owned by the company are located in a safety deposit box at a local bank or are held in a banking and trust company under a custodial agreement.

Bonds in the safety deposit box were physically inspected by the examiners. Bonds held under the custodial agreement were verified by review of the custodian's year-end statement of the company's investments. Selected bond purchases and sales for the period under examination were also checked to the custodian's account statements. The company's investment in bonds was in compliance with Wisconsin Statutes and the rules of the Commissioner of Insurance as regards investments made by town mutual insurers, except regarding the classification of three municipal bonds as noted earlier in this report..

The examination noted several instances where securities reported by the company in Schedule C did not include accurate CUSIP identification numbers nor properly reported the maturity dates. It is recommended that in future Annual Statements, the company report accurate CUSIP identification numbers and maturity dates on Schedule C, Section 1, in accordance with the Town Mutual Annual Statement Instructions.

The examination also noted the company holds a line of credit amounting to $50,000 with a local bank, which was unused at year end. The line of credit is secured by two bonds and two corporate notes. The securities are held by Trade Lake Mutual in their safety deposit box at the local bank, which was verified by the examiner.

Interest received during 2002 on bonds amounted to $22,261 and was traced to cash receipts records. Accrued interest of $5,986 at December 31, 2002, was verified.

Stocks and Mutual Fund Investments $336,859

The above asset consists of the aggregate market value of stocks and mutual funds held by the company as of December 31, 2002. Stocks owned by the company are located in a safety deposit box at a local bank or are held in a banking and trust company under a custodial agreement.

Stock certificates in the safety deposit box were physically examined by the examiners. Stock certificates held under the custodial agreement, were verified by review of the custodian's year-end statement of the company's investments. Stock and mutual fund purchases and sales for the period under examination were checked to brokers' invoices and advices. The company's investment in stocks and mutual funds was in conformance with Wisconsin Statutes and the rules of the Commissioner of Insurance as regards investments made by town mutual insurers.

Dividends received during 2002 on stocks and mutual funds amounted to $2,362 and were traced to cash receipts records. Company did not have accrued dividends on stocks and mutual funds at December 31, 2002.

Book Value of Real Estate $40,468

The above amount represents the company's investment in real estate as of December 31, 2002. The company's real estate holdings consisted of an office building owned and occupied by the company.

The required documents supporting the validity of this investment were reviewed. Adequate hazard insurance was carried on the real estate and contents as noted under the caption, "Fidelity Bond and Other Insurance." The company's investment in real estate and related items was in conformance with the Wisconsin Statutes and the rules of the Commissioner of Insurance as regards investments made by town mutual insurers. Real estate depreciation is calculated using the double declining balance method.

Through discussion with company personnel examiners found that problems have developed with the building's foundation. The company is obtaining an estimate for repairs.

Premium in Course of Collection **$815**

The above ledger asset represents the amounts due from agents or policyholders which are not in excess of 90 days past due at year-end. A review of individual agent's accounts for subsequent receipt of premium payments verified the accuracy of this asset.

Deferred Premium **$158,086**

The above asset represents deferred premium receivables for policies currently in-force. The deferred premiums will be billed and will be due in the following year for those policies issued by the company that are paid for on an installment basis by the respective insureds. This account was adjusted by $8,087 due to an error in the company's accounting related to installment premiums received on in-force policies prior to their due dates. These premium receipts should have decreased the deferred premium asset rather than increasing the advance premium liability. A reclassification entry crediting the deferred premium asset and debiting advance premium was made to these accounts to reflect the actual balances as of December 31, 2002. It is recommended that the company properly account for installment premiums received in advance in the future annual statements.

The examination also noted in the Accounts and Records section that the company potentially misstated its deferred premium due to different amounts of premium in-force being used in determining year end amounts. No adjustment to the account balance was proposed due to the lack of materiality.

Investment Income Due and Accrued **$5,986**

Interest due and accrued on the various assets of the company at December 31, 2002, consisted of bond investment income of $5,986. Accrued income amounts as of December 31, 2002 were verified by recalculation.

Reinsurance Recoverable on Paid Losses **$4,977**

The above asset represents recoveries due to the company from reinsurance on losses which were paid on or prior to December 31, 2002. A review of year-end accountings with the reinsurer verified the above asset.

Electronic Data Processing Equipment **$2,467**

This asset consists of computers and printers owned by the company at December 31, 2002. This asset was verified by reviewing purchase documentation, and testing accumulated depreciation.

Equipment, Furniture, and Supplies **$0**

This asset consists of $74 of furniture and non-EDP equipment owned by the company at December 31, 2002. In accordance with annual statement requirements, this amount has been reported as an asset not admitted.

Reinsurance Contingent Commission Receivable **$17,305**

The above asset represents reinsurance ceding commission receivable from the reinsurer on the company's class B – First Surplus reinsurance contract. The reported balance equals the net sliding scale commission for the year 2002 in excess of the monthly provisional commission of 15% allowed on ceded premium during the year. The balance was verified by review of year-end reinsurer's accounting and was traced to subsequent 2003 cash receipts.

LIABILITIES AND SURPLUS

Net Unpaid Losses **$28,144**

This liability represents losses incurred on or prior to December 31, 2002, and remaining unpaid as of that date. The examiners' development of unpaid losses is compared with the amount estimated by the company in the following schedule.

	Company Estimate	Examiners' Development	Difference
Incurred But Unpaid Losses	$ 216,178	$ 202,844	$ 13,334
Less:			
Reinsurance Recoverable on Unpaid Losses	180,068	174,700	(5,368)
Net Unpaid Losses	$ 36,110	$ 28,144	$ 7,966

The examiners developed this liability by totaling actual loss payments made through the development period on those losses incurred on or prior to December 31, 2002. To the actual paid loss figures was added an estimated amount for those 2002 and prior losses remaining unpaid at the examination date.

The company used the total liability claims from WRC claim register and also included 14 non-property claims totaling $13,334 from their own year end listing which were included in the WRC claim register, resulting in the claims being double counted. The resulting difference, net of $5,368 reinsurance recoverable, was $7,966 and is reflected in the section of this report captioned "Reconciliation of Policyholders' Surplus." It is recommended that the company reconcile its unpaid non-property losses with WRC reports making appropriate adjustments to account for year(s) the company may have reached their stop loss attachment point.

The examiners' review of claim files included open claims, paid claims, claims closed without payment, and all claims which were denied during the examination period. The review indicated that claims are investigated and evaluated properly and that payments are made promptly and in accordance with policy provisions upon the submission of a proper proof of loss. The company has established new procedures for adjusting losses since the prior exam. Changes are reflected in the section of this report captioned “Current Examination Results” under

Business Plan, Strategy Number 3: Adjustment of Losses. In addition, the review of claims handling procedures and files revealed the following:

1. A proper loss register is maintained.
2. Claim files contained sufficient investigatory data and documentation to verify settlement payments or reserve estimates.
3. Proofs of loss were properly signed.

The examiner reviewed company's compliance with the Rimes decision which states that insurance companies are to reimburse subrogation to the insured every six months or when $100 has been collected on behalf of the insured. Company has developed procedures to comply with the Rimes decision and is actively following those procedures.

The company has developed and implemented a more extensive loss analysis since the prior examination. This analysis includes review of policies with frequent losses, tracking claims by agents, and performing analysis of claims for line of business, policy type and time of year.

Unpaid Loss Adjustment Expenses $3,623

This liability represents the company's estimate of amounts necessary to settle losses which were incurred prior to December 31, 2002, but which remained unpaid as of year-end. The methodology used by the company in establishing this liability is an estimate using a percentage of losses based on historical data.

The examiners' analysis of expenses incurred in the current year related to the settlement of prior year losses, as well as estimates of amounts necessary to settle any prior losses remaining unpaid at the examination date, determined this liability to be adequately stated.

Commissions Payable $28,709

This liability represents the commissions due and payable to company agents as of December 31, 2002. Supporting commission registers and subsequent cash disbursement records were reviewed to verify the above amount.

Fire Department Dues Payable **$741**

This liability represents the fire department dues payable at December 31, 2002. The examiners reviewed the company's fire department dues calculation and found this liability to be correctly calculated. The actual amount paid was verified to the cash disbursement records.

Unearned Premiums **$394,164**

This liability represents the reserve established for unearned premiums in compliance with s. Ins 13.08 (3), Wis. Adm. Code. This reserve was established using a daily pro rata methodology.

The examination noted in the Accounts and Records section that the company potentially misstated its unearned premium reserve due to different amounts of premium in-force on different computer-generated reports. No adjustment to the account balance was proposed due to the lack of materiality.

Reinsurance Payable **$91,410**

This liability consists of amounts due to the company's reinsurer at December 31, 2002, relating to transactions which occurred on or prior to that date. The following table shows the reinsurance payable for each of the company's coverages.

Class A – Liability	$ 1,601
Class B – First Surplus	18,368
Deferred Class B – First Surplus	34,450
Class B – Quota Share	9,064
Deferred Class B – Quota Share	23,027
Class C-2	700
Class D/E	4,200
Total	$ 91,410

Subsequent cash disbursements and reinsurance accountings verified the amount of this liability.

Amounts Withheld for the Account of Others **$2,136**

This liability represents employee payroll deductions in the possession of the company at December 31, 2002. Supporting records and subsequent cash disbursements verified this item.

Accounts Payable **$4,118**

This liability represents the balance payable at year-end for accounts payable and other accrued expenses incurred on or prior to December 31, 2002. The examiner verified this balance by tracing the detail to supporting invoices and cancelled checks, and by reviewing cash disbursements in January 2003, to ensure that all liabilities incurred prior to January 1, 2003 were properly accrued at year-end.

Premiums Received in Advance **$14,838**

This liability represents premiums received for policies with effective dates in the subsequent year. An examination of this account revealed that cash installments received on mid-term policies were incorrectly included here, rather the deferred installments receivable should have been decreased. A reclassification was made reducing the deferred and advance premiums in the amount of $8,087.

V. CONCLUSION

Trade Lake Town Mutual Insurance Company is a town mutual insurer covering a six county area. The company has been in business for more than 129 years providing property and liability insurance to its policyholders.

The current examination resulted in one suggestion, two repeat recommendations and eleven new recommendations. The majority of the recommendations related to reporting errors on the company's filed 2002 annual statement. Due to reporting errors an adjustment and reclassification was made resulting in an exam adjustment increasing policyholder's surplus by $7,966, bringing policyholder's surplus to $369,678.

In the five years since the prior examination the number of policies in force decreased by 21% to 1,902 policies, whereas gross and net premium written both increased by 9% to $1,135,695 and $624,599, respectively. The growth of gross and net premium written reflects an increase in the insurance to value and rate increases.

The company experienced a decrease in surplus during the period since the prior 1997 examination of approximately 51% from $761,899 to $369,678. The company had an underwriting loss and net operating loss each year except for 2002. The company's assets have declined 30% from $1,336,209 to $937,560. Liabilities decreased 16% from $676,466 to $567,882.

The company deserves credit for improving its underwriting results over the past year. Actions taken by company to improve results include tougher underwriting standards, adjusting guidelines, increases to premium rates, policy fees and better defined roles of management. However, the minimum required surplus for town mutual insurers is $200,000, and the company continues to be close to that limit.

VI. SUMMARY OF COMMENTS AND RECOMMENDATIONS

1. Page 18 - Corporate Records— It is recommended that the company report biographical data to the Commissioner within 15 days of the election or appointment of a new director or officer, in accordance with the provisions of s. 612.15 (1), Wis. Stats.

2. Page 20 - Conflict of Interest— It is again recommended that the directors properly disclose all potential conflicts on the annual conflict of interest form..

3. Page 20 - Conflict of Interest— It is also suggested to company that the board of directors clarify their conflict of interest statement to define circumstances that would be considered conflicts.

4. Page 20 - Conflict of Interest— It is recommended that directors abstain on issues where a conflict of interest exists per s. 612.18, Wis. Stat. and such abstentions are to be included in the board minutes.

5. Page 22 - Underwriting— It is again recommended that the company document in the underwriting file how outbuildings were valued using valuation guides and include photographs of the risk.

6. Page 23 - Accounts and Records— It is recommended that the company revise its disbursement policy to require two live signatures on all disbursements over a specified amount approved by the board, pursuant to s. Ins 13.05(4)(b), Wis. Adm. Code.

7. Page 23 - Accounts and Records— It is recommended that the company determine a premium in-force and use that for the basis for unearned and deferred premium.

8. Page 25 - Invested Assets— It is recommended that the company comply with s. Ins 13.05, Wis. Adm. Code, as regards custody and control of its invested assets.

9. Page 25 - Invested Assets— It is recommended that the company's custodial statement include appropriate language with respect to indemnification and prompt replacement in the event of loss of securities.

10. Page 26 - Invested Rule Compliance— It is recommended company report the correct Type designation for all securities pursuant to s. Ins 6.20 (6) (d) 9, Wis. Adm. Code.

11. Page 28 - Book Value of Bonds— It is recommended that in future Annual Statements, the company report accurate CUSIP identification numbers and maturity dates on Schedule C, Section 1, in accordance with the Town Mutual Annual Statement Instructions.

12. Page 30 - Deferred Premium— It is recommended that the company properly account for installment premiums received in advance in the future annual statements.

13. Page 32 - <u>Net Unpaid Losses</u>— It is recommended that the company reconcile its unpaid non-property losses with WRC reports making appropriate adjustments to account for year(s) the company may have reached their stop loss attachment point.

VII. ACKNOWLEDGMENT

The courteous cooperation extended to the examiners by the company's personnel is hereby acknowledged.

In addition to the undersigned, David Grinnell of the Office of the Commissioner of Insurance, State of Wisconsin, participated in the examination.

Respectfully submitted,

Rebecca Easland
Examiner-in-Charge